

SANBORN & SANBORN ACCOUNTANCY CORPORATION

Review Report

QUALITY CONTROL REVIEW

For the Firm's Audit of
Rockford Elementary School District
for the Fiscal Year Ended June 30, 2002



STEVE WESTLY
California State Controller

April 2004



STEVE WESTLY
California State Controller

April 23, 2004

Mr. Max Sanborn
Sanborn & Sanborn
Accountancy Corporation
1423 11th Street
Reedley, CA 93654

Dear Mr. Sanborn:

The State Controller's Office has completed a quality control review of Sanborn & Sanborn Accountancy Corporation. We reviewed the audit working papers for the firm's audit of Rockford Elementary School District for the fiscal year ended June 30, 2002.

A draft report was issued on February 18, 2004. In a telephone conversation on March 25, 2004, you indicated that you agreed with the findings as discussed during the exit conference on December 13, 2003, and that your firm will not respond in writing to the draft report.

If you have any questions, please contact Casandra Moore-Hudnall, Chief, Financial Audits Bureau, at (916) 322-4846.

Sincerely,

A handwritten signature in dark ink, reading "Vincent P. Brown", is positioned above the printed name and title.

VINCENT P. BROWN
Chief Operating Officer

VPB:ams/jj

cc: Jim Vidak, Superintendent
Tulare County Office of Education
Andrew Schultz, Principal
Rockford Elementary School District
Arlene Matsuura, Educational Consultant
School Fiscal Services Division
California Department of Education
Charles Pillsbury
School Apportionment Specialist
Department of Finance

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Review Report

Summary

The State Controller's Office (SCO) has completed a quality control review of the audit working papers for an audit performed by Sanborn & Sanborn Accountancy Corporation of the Rockford Elementary School District for the fiscal year (FY) ended June 30, 2002. The last day of fieldwork was December 16, 2003.

The audit referred to above was performed in accordance with the majority of the standards and requirements set forth in *Government Auditing Standards*, issued by the Comptroller General of the United States, often referred to as generally accepted government auditing standards (GAGAS); U.S. generally accepted auditing standards (GAAS); Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*; and the *Standards and Procedures for Audits of California K-12 Local Educational Agencies* (K-12 Audit Guide), published by the SCO. However, the SCO reviewers noted the following exceptions:

- The firm did not comply with GAAS and GAGAS with regard to fieldwork standards for financial audits and due professional care standards; and
- The firm did not comply with K-12 Audit Guide requirements.

Background

Any governmental unit subject to a single audit must have the audit performed in accordance with the standards referred to in this report. According to OMB Circular A-133, the auditor's work is subject to a quality control review at the discretion of an agency granted cognizant or oversight status by the federal funding agency. In addition, *Education Code* Section 14504.2 authorizes the SCO to perform quality control reviews of working papers for audits of K-12 local educational agencies (LEAs) to determine whether audits are performed in accordance with U.S. General Accounting Office standards for financial and compliance audits.

Sanborn & Sanborn Accountancy Corporation is an independent certified public accounting firm with an office in Reedley, California. The firm performed two LEA audits for FY 2001-02. The firm has been the independent auditor for Rockford Elementary School District since FY 1995-96. During FY 2001-02, the district operated one elementary school, with a total average daily attendance (ADA) of 329 for the purpose of state funding.

**Objectives,
Scope, and
Methodology**

The general objectives of the quality control review were to determine whether this audit was conducted in compliance with:

- GAGAS
- GAAS
- K-12 Audit Guide
- OMB Circular A-133

The quality control review was conducted at the office of Sanborn & Sanborn Accountancy Corporation. The SCO reviewers compared the audit work performed by the firm, as documented in the working papers, with the standards stated in the general objectives.

Conclusion

The audit referred to above was performed in accordance with the majority of the standards and requirements set forth in GAGAS, GAAS, OMB Circular A-133, and the K-12 Audit Guide. However, the SCO reviewers noted the exceptions discussed in the Findings and Recommendations section of this report.

This report is applicable solely to the audit working papers referred to above and is not intended to pertain to any other work of Sanborn & Sanborn Accountancy Corporation.

**Views of
Responsible
Official**

The SCO issued a draft report on February 18, 2004. In a telephone conversation on March 25, 2004, Max Sanborn indicated that he agreed with the findings as discussed during the exit conference on December 13, 2003, and that the firm would not respond in writing to the draft report.

Restricted Use

This report is intended solely for the information and use of the specified parties; it is not intended to be and should not be used for any other purpose. This restriction is not meant to limit distribution of the report, which is a matter of public record.



JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

Findings and Recommendations

General

The Single Audit Act and the *Standards and Procedures for Audits of K-12 Local Educational Agencies* (K-12 Audit Guide), published by the SCO, require audits to be performed in accordance with U.S. generally accepted auditing standards (GAAS). These standards deal with the quality of the audits performed by the independent auditor and have been approved and adopted by the American Institute of Certified Public Accountants (AICPA). GAAS is divided into three areas: (1) general standards; (2) fieldwork standards; and (3) reporting standards. The three areas are divided into ten specific standards. In addition to GAAS, auditors of governmental entities must also perform audits in accordance with generally accepted government auditing standards (GAGAS), which expands the GAAS in several areas.

In the course of this quality control review, the SCO reviewers found that Sanborn & Sanborn Accountancy Corporation did not comply with some elements of the GAAS and GAGAS.

In addition, the firm did not adequately document testing of the state compliance requirements of the K-12 Audit Guide.

Noncompliance with Fieldwork Standards for Financial Audits (GAGAS, GAAS)

FINDING 1— Due professional care

The firm did not perform the audit procedures for the State Instructional Materials program and Kindergarten Continuation, as required by the K-12 Audit Guide. No documentation was included in the working papers to substantiate the reason(s) for not performing the audit procedures. The firm acknowledged that these procedures were not performed.

GAGAS 3.28 states:

Exercising due professional care means using sound judgment in establishing the scope, selecting the methodology, and choosing tests and procedures for the audit. The same sound judgment should be applied in conducting the tests and procedures and in evaluating and reporting the audit results.

AU Section 230.02 states:

This standard requires the independent auditor to plan and perform his or her work with due professional care. Due professional care imposes a responsibility upon each professional within an independent auditor's organization to observe the standards of field work and reporting.

AU Section 230.04 states:

The matter of due professional care concerns what the independent auditor does and how well he or she does it. . . .

The auditor's opinion on state compliance may be incorrect because appropriate procedures were not performed.

Recommendation

The firm should comply with professional audit standards and exercise due professional care in the performance of the audit.

FINDING 2— Service organization consideration

The firm did not comply with standards with regard to consideration of controls at the Tulare County Office of Education. The Tulare County Office of Education, which processes, reviews, and distributes all disbursements, maintains and processes payroll, and maintains the general ledger system for the Rockford Elementary School District, is considered a service organization for the district. The district only has the capability of inputting data into the system.

The firm performed substantive testing of payroll and other disbursements of the district; however, the firm did not perform any testing on the controls or review the audit report of the Tulare County Office of Education.

AU Section 324.12 states:

A service auditor's report on controls placed in operation at the service organization should be helpful in providing a sufficient understanding to plan the audit of the user organization. Such a report, however, is not intended to provide any evidence of the operating effectiveness of the relevant controls that would allow the user auditor to reduce the assessed level of control risk below the maximum. Such evidential matter should be derived from one or more of the following:

- a. Tests of the user organization's controls over the activities of the service organization (for example, the user auditor may test the user organization's independent re-performance of selected items processed by an EDP service center or test the user organization's reconciliation of output reports with source documents).
- b. A service auditor's report on controls placed in operation and tests of operating effectiveness, or a report on the application of agreed-upon procedures that describes relevant tests of controls.
- c. Appropriate tests of controls performed by the user auditor at the service organization.

AU Section 324.13 states:

The user organization may establish effective controls over the service organization's activities that may be tested and they may enable the user auditor to reduce the assessed level of control risk below the maximum for some or all of the related assertions. If a user organization, for example, uses an EDP service center to process payroll transactions, the user organization may establish controls over input and output data to prevent or detect material misstatements. The user organization might re-perform the service organization's payroll calculations on a test basis. In this situation, the user auditor may perform tests of the user

organization's controls over data processing that would provide a basis for assessing control risk below the maximum for the assertions related to payroll transactions. The user auditor may decide that obtaining evidence of the operating effectiveness of the service organization's controls, such as those over changes in payroll programs, is not necessary or efficient.

AU Section 324.14 states:

The user auditor may find that controls relevant to assessing control risk below the maximum for particular assertions are applied only at the service organization. If the user auditor plans to assess control risk below the maximum for those assertions, he or she should evaluate the operating effectiveness of those controls by obtaining a service auditor's report that describes the results of the service auditor's tests of those controls (that is, a report on controls placed in operation and tests of operating effectiveness, or an agreed-upon procedures report) or by performing tests of controls at the service organization. If the user auditor decides to use a service auditor's report, the user auditor should consider the extent of the evidence provided by the report about the effectiveness of controls intended to prevent or detect material misstatements in the particular assertions. The user auditor remains responsible for evaluating the evidence presented by the service auditor and for determining its effect on the assessment of control risk at the user organization.

AU Section 324.15 states:

The user auditor's assessments of control risk regarding assertions about account balances or classes of transactions are based on the combined evidence provided by the service auditor's report and the user auditor's own procedures. In making these assessments, the user auditor should consider the nature, source, and interrelationships among the evidence, as well as the period covered by the tests of controls. The user auditor uses the assessed levels of control risk, as well as his or her understanding of internal control, in determining the nature, timing, and extent of substantive tests for particular assertions.

Recommendation

The firm should comply with GAAS with regard to the consideration of a service organization's impact on its auditee's operation and controls.

Noncompliance with Generally Accepted Government Auditing Standards (GAGAS)

FINDING 3— Continuing professional education

The firm did not provide evidence that audit staff complied with Section 3.6 of the *Government Auditing Standards* requirement that audit staff conducting substantial portions of the fieldwork on the audit complete the required 24 hours of continuing education and training in subjects directly related to the government environment and government auditing.

Government Auditing Standards Section 3.6 states:

To meet this standard, the audit organization should have a program to ensure that its staff maintain professional proficiency through continuing education and training. Thus, each auditor responsible for planning, directing, conducting, or reporting on audits under these standards should complete, every 2 years, at least 80 hours of continuing education and training which contributes to the auditor's professional proficiency. At least 20 hours should be completed in any 1 year of the 2-year period. Individuals responsible for planning or directing an audit, conducting substantial portions of the field work, or reporting on the audit under these standards should complete at least 24 of the 80 hours of continuing education and training in subjects directly related to the government environment and to government auditing. If the audited entity operates in a specific or unique environment, auditors should receive training that is related to that environment.

Recommendation

The firm should comply with GAGAS with regard to all aspects of CPE requirements. In addition, the firm should maintain and/or provide documentation that audit staff has complied with the requirements.

**FINDING 4—
Quality control
deficiencies**

The firm did not meet GAGAS standards for internal quality control and has not provided a copy of an external quality control review for SCO review. The audit firm has no internal quality control system in place. However, according to the president, the firm does participate in an external quality review program.

GAGAS Section 3.31, the fourth general standard, states:

Each audit organization conducting government audits in accordance with these standards should have an appropriate internal quality control system in place and undergo an external quality control review.

GAGAS Section 3.32 states:

The internal quality control system established by the audit organization should provide reasonable assurance that it (1) has adopted, and is following, applicable auditing standards and (2) has established, and is following, adequate policies and procedures.

GAGAS Section 3.33 states:

The external quality control review should determine whether the organization's internal quality control system is in place and operating effectively to provide reasonable assurance that established policies and procedures and applicable auditing standards are being followed.

Without an internal quality control system, there is no assurance that the firm is following all applicable auditing standards. The audit report may contain false assertions and deceptive statements due to the firm's failure to conform to auditing standards. Findings 1 and 5 demonstrate why a quality control system is critical.

Recommendation

The firm should establish policies and procedures to ensure all audits are conducted in accordance with standards. The firm should participate in an external quality control review at least once every three years and provide a copy of the letter issued as a result of the review.

Noncompliance with K-12 Audit Guide Requirements (GAAS, GAGAS)

FINDING 5— Evidential matter deficiencies

During the review of the firm's working papers, the following deficiencies were noted:

- Testing was not performed on Independent Study as required in the K-12 Audit Guide as the district advised the firm that it did not claim any Independent Study Average Daily Attendance (ADA). However, no additional procedures were performed to verify that the district had not included short-term independent study in its regular attendance and that it was appropriate to pass on testing the Independent Study program.
- No evidence was provided that the firm determined whether the teachers possessed valid credentials for FY 2001-02. As a result, it was not clear whether the firm performed procedure 3 for the Class Size Reduction, Option 1 program, regarding teacher credentialing.
- No evidence was provided that the firm determined whether the district was in compliance with Gann Limit requirements.

The accuracy of the auditor's opinion on state compliance may be impaired when evidential matter gathered is not sufficient and competent, or the appropriate audit steps were not performed.

AU Section 319.105 states in part that the auditor uses this evidential matter as part of the reasonable basis for an opinion referred to in the third standard of fieldwork, which follows:

Sufficient competent evidential matter is to be obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statements under audit.

AU Section 326.13 states in part:

The evidential matter obtained should be sufficient for the auditor to form conclusions concerning the validity of the individual assertions embodied in the components of financial statements.

AU Section 326.16 states in part:

Accounting data alone cannot be considered sufficient support for financial statements; on the other hand, without adequate attention to the propriety and accuracy of the underlying accounting data, an opinion on financial statements would not be warranted.

GAGAS Section 4.35 states:

Working papers should contain sufficient information to enable an experienced auditor having no previous connection with the audit to ascertain from them the evidence that supports the auditors' significant conclusions and judgments.

Section 510 of the K-12 Audit Guide States in part:

... All state requirements identified in Section 520 that are applicable to the entity must be tested for compliance with state laws and regulations. ... Each compliance requirement is accompanied by suggested audit procedures that can be utilized as determined by the auditor's professional judgment.

Recommendation

The firm should ensure that the working papers provide sufficient documentation to support the auditor's conclusions and judgments. The firm should follow all standards when performing audits of local educational agencies. All required procedures of the K-12 Audit Guide should be performed and documented or the working papers should contain documentation as to the rationale for procedures not being performed or for alternate procedures being performed.

FINDING 6— Reporting deficiencies

The auditor's report on state compliance lists all programs to be tested for state compliance requirements as well as the number of audit procedures for each program. The auditors are directed to provide an explanation in the report when a program is not tested, an audit procedure is not performed, or an alternate procedure is performed (*Education Code* Section 14503). The independent auditor's report on state compliance incorrectly stated that the auditor performed all of the suggested audit procedures for Attendance Reporting, Kindergarten Continuation, Independent Study, Gann Limit Calculation, Class Size Reduction, and State Instructional Materials (K-8). As noted in Finding 5, the firm did not perform all of the suggested audit procedures for Attendance Reporting, Independent Study, Gann Limit Calculation, and Class Size Reduction, and did not provide explanations as to why these procedures were not performed. Further, the audit report did not contain explanations as to why the Kindergarten Continuation and Instructional Materials procedures were not performed, as noted in Finding 1.

Education Code Section 14503(a) states:

Every audit report shall specifically and separately address each of the state compliance program requirements included in the audit guide, stating whether or not the district is in compliance with those requirements. For each state program compliance requirement included in the audit guide, every audit report shall further state the suggested audit procedures included in the audit guide for that requirement were followed in the making of the audit, if that is the case, or, if not, what other procedures were followed.

Recommendation

The firm should comply with the *Education Code* and include in the auditor's report on state compliance the actual number of procedures performed for each program and, if not all procedures were performed, an explanation why any procedure was not performed or a description of any alternate procedures performed.

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